FYTOKEM

2003 ANNUAL REPORT

Table of Contents

PRESIDENT'S MESSAGE

2003 was a challenging but successful year for Fytokem. We had our first and second patents issued early in 2003. The first relates to the production and use of our Tyrostat™ line of products, while the second relates to Oenothein-B, one of the bio-active molecules in our Canadian Willowherb™ line of products. These confirm the quality of the science behind our products and are a tribute to the early work done by our research team and the recent efforts in finalizing this work to get the actual patents issued.

Also during 2003, we recorded our first quarterly profit – in fact, we had two profitable quarters enroute to our lowest annual operating loss ever. Revenues increased during the year, as our products gained acceptance in the natural marketplace on several continents. Our working relationship with Atrium Biotechnologies Inc. developed throughout the year while we control costs wherever possible.

Sales growth, although modest, reflects the fact that essentially all of our customers made the transition to our new marketing partner. In addition to the sales reflected in our financial statements, we also repurchased and resold the inventory held by our former marketing partner. The proper accounting treatment of this transaction was not to record it as a sale and therefore the sales growth figure recorded in our financial statements was understated by just over 27%. Actual sales growth in the marketplace was then about 33%.

During the fourth quarter of 2003 and continuing into 2004, we completed a detailed review of our products and our performance as a supplier. In conjunction with our partner, Atrium, we looked carefully at the quality, efficacy and consistency of our products. We studied the market and the demands being placed on us by our customers and we reviewed our ability to fully meet these demands.

As the market for natural ingredients grows, and as the use of natural products matures in our target markets we need to improve in terms of the efficacy and the quality of the products we offer the marketplace. As we conclude this detailed review, I am pleased to advise you that Atrium continues to put a very enthusiastic effort into growing the market for our products and I am even more confident that our existing products will achieve stronger sales in an ever growing and changing market.

The other encouraging trend with our sales is the acceptance of our products by some of the largest customers in the personal care industry and at the same time growth among the smaller customers. Our products appeal to a broad range of customers, and Atrium supports them with strong marketing efforts. The use by industry giants such as Johnson & Johnson confirms the true efficacy and quality of our products and helps provide strong volume growth, while the continued sales among smaller customers allows us to reduce our reliance on individual customers.

As our working relationship with Atrium develops and we focus on product quality and development, based on market feedback, some new and exciting opportunities have become evident. One example of this is our joint development of a slightly modified Canadian Willowherb™ product for use by a major client in Japan. At present, we are doing development work on this modified product and the customer is already doing their final product development trials. Strong market feedback and a good working relationship with our marketing partner combined with our own research and production abilities and understanding of our product will allow us to access exciting new markets.

During the next year we will:

- Focus on product quality and improvements to our existing product lines. The marketplace demands new and different product formats and ever increasing product quality, driven by a wide variety of market circumstances.
- As our sales grow we will begin to expand our scientific staff to ensure our ability to stay ahead of market demands.
- Look at new market opportunities for our products both in the personal care industry through Atrium and in other industry sectors as our own time and resources permit.

Sincerely,

Art Hesje

Art Hesje
President & Chief Executive Officer

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis outlines the Company's results of operations, financial condition and cash flows. The following discussion should be read in conjunction with the audited financial statements and accompanying notes prepared in accordance with Canadian generally accepted accounting principles. This discussion and analysis includes forward-looking statements that may differ materially from actual results achieved.

OVERVIEW

Fytokem Products Inc. is engaged in the discovery and commercialization of novel *Function-Certified*™ plant-based substances – extracts, phytochemicals and bioactive molecules – for use as ingredients in personal care, nutraceutical, pharmaceutical and bio-industrial products.

2003 highlights include the following:

- The Company recorded a $144,082 loss from its operations in the year, a 76% improvement over 2002.
- The loss per share dropped to $0.01 from $0.04 in 2002
- Revenues were 56% greater than in 2002.
- Sales were 6% greater than in 2002.
- The Company was able to reduce its overall expenses by 10% during the year.

RESULTS OF OPERATIONS

The Company experienced a net loss of $144,082 or $0.01 per share in 2003, 76% better than the 2002 loss of $597,644 or $0.04 per share. As at December 31, 2003, the Company's working capital, current assets less current liabilities, was ($277,146); $546,719 lower than the working capital at December 31, 2002. Total assets were $540,012, $781,477 lower than at December 31, 2002. The capital deficiency amounted to $515,796, which includes an accumulated deficit of $4,599,950.

REVENUES

Total revenues for 2003 were 988,068, 56% greater than in 2002. This variance from 2002 is due to an increase in product sales and the recognition of marketing agreement revenue.

Product sales for the year were $577,429, 6% greater than in the 2002. Although the growth in product sales was less than expected for the year, the Company expects stable growth in the future as a direct result of the product sales commitments made by the Company's distributor, Atrium Biotechnologies Inc. Project revenues were $4,013 lower than in 2002 as a result of the reduced participation in government-sponsored programs.

The Company recognized $360,000 in revenue from the Atrium Cooperation and License Agreement in 2003. The total amount of revenue recognized to date under this agreement is $390,000.

Other revenue, which is mainly comprised of interest revenue, fluctuates with the Company's cash balance.

The gross margin on product sales of 69% in the year is essentially the same as in 2002.

OPERATING EXPENSES

The Company reduced its total expenses by $110,527 in the year. This 10% reduction is reflected in substantial decreases in all expense categories, except amortization and interest expense, which rose slightly. The Company expects this level of expenses to continue for the foreseeable future.

Product development expenses for the year were $280,229 compared to $345,502 for 2002. This 19% reduction is the result of general cost and staff reductions in all product development areas. Expenditures in this area are expected to continue at the current level.

Marketing expenses were $182,809 compared to $202,256 for 2002. This 10% reduction is the result of general cost reductions in all aspects of the marketing function and a shifting of marketing expenses to our marketing partner. It should be noted that the direct costs associated with the setup and implementation of the Atrium Cooperation and License Agreement have been deferred and are being amortized over the same period as the corresponding revenue is recognized. Direct costs of $77,487 were deferred in the year as compared to $29,215 in 2002. The Company amortized

$42,248 of these costs in 2003, as compared to $1,169 in 2002.

Finance and administration costs were $362,812 compared to $391,366 for 2002. This represents a 7% decrease and is the result of savings in salaries, investor relations, corporate governance costs and professional fees partly offset by increases in insurance, occupancy costs, office supplies (packaging) and foreign exchange conversion costs.

Interest on debt is slightly higher than in the corresponding periods in 2003 because of the increased amortization of the equity portion of the promissory note in the year.

INFLATION, RISK AND FOREIGN EXCHANGE

The impact of inflation on the Company's operations has been minimal and is expected to be minimal in the next few years. Fluctuating foreign exchange rates have historically had a greater impact than inflation. Substantially all sales transactions are now, and will continue to be, denominated in Canadian Dollars. The exception to this is in the isolated transactions surrounding the Dragoco inventory, which were in US Dollars. As a result of record high Canadian Dollar exchange rates in the year, the Company experienced a $14,472 loss on conversion of foreign currency balances in the year. No foreign currency hedges were placed to mitigate this risk. All in all, the Company feels its risk of foreign currency fluctuations in its operations has declined substantially.

MANAGEMENT CHANGES

Fytokem's Director of Research & Development, Janice McColl resigned effective May 31, 2003.

Fytokem's Vice–President – Marketing & Corporate Development, Greg Dutka resigned effective July 11, 2003.

Fytokem's Vice–President – Finance & Administration & Corporate Secretary – Treasurer, Mark Pasloski resigned effective October 31, 2003.

LIQUIDITY AND CAPITAL RESOURCES

Since inception, the Company has financed its operations and capital expenditures primarily through equity offerings, long term debt and, to a lesser extent, third-party (including government-sponsored) research grants and marketing agreement revenues. For the past few years, product sales have contributed significantly to the Company's cash flows, thereby reducing the reliance on external sources of capital.

Other than the increase in product sales, the Company had the following significant transactions that affected its cash balance for the year ended December 31, 2003:

- During the year inventory was re-purchased and subsequently re-sold to Atrium Biotechnologies Inc. for a total value of $153,013. This re-purchase and re-sale of inventory was not recorded as a sale. In addition, the Company incurred a loss ($61,038) on this transaction due to direct costs of transporting the inventory to the Company's warehouse and the severe drop in the value of the US Dollar which directly affected the price paid to Dragoco for this inventory. This loss was added to the marketing agreement costs and will be amortized in the normal manner.
- The Agri-Food Equity Fund agreed to defer the principal payment of $50,000 due on July 1, 2003 to July 1, 2007.

At December 31, 2003, Fytokem had cash and cash equivalents of $53,278 and accounts receivable of $72,191. Working capital, current assets less current liabilities was ($277,146), $546,719 lower than the working capital at December 31, 2002. If deferred marketing revenue, which does not involve cash, was eliminated from the current liabilities total, the working capital would have been $19,569 at December 31, 2003.

Although the Company's growing sales revenues are expected to fund its finance, administration and basic quality control functions, the Company is not entirely confident that its existing capital resources, plus anticipated cash flows, will be adequate to satisfy its anticipated cash requirements for its operations for the next 12 months. The Company expects that it will be necessary to further reduce its expenditures and/or seek additional debt or equity financing in the near future to fund its operations. It is also expected that any expansion in research and development and marketing activities would be financed through additional debt or equity financing. It should be noted that if financing is not available to the Company on favorable terms, this may severely affect the Company's continued growth.

FORWARD LOOKING STATEMENTS

This Management's Discussion And Analysis Of Financial Condition And Results Of Operations contains forward-looking statements concerning the Company's activities and prospects in future periods. All statements other than statements of fact may be deemed forward-looking statements. Forward-looking statements frequently, but not always use the words "expects", "anticipates", "suggests", "plans", "believes" or "intends", or similar words and/or include statements concerning the Company's strategies, goals and plans, or state that certain actions, events or results "will" be taken, occur or be achieved. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the results, performance or achievement of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such statements. Such factors include, among others: uncertainties related to early stage of development, technology and product development; dependence on future corporate collaborations; dependence on proprietary technology and uncertainty of patent protection; management of growth; future capital needs and uncertainty of additional funding; intense competition; manufacturing and market uncertainties; government regulation; product liability exposure and insurability. These and other factors are described in detail in the Company's reports, releases and other information filed with the Saskatchewan, Alberta and B.C. Securities Commissions. Forward-looking statements are based on current expectations and Fytokem is not obligated to update such information to reflect later events or developments.

MANAGEMENT'S RESPONSIBILITIES FOR FINANCIAL REPORTING

Management is responsible for the preparation and integrity of the Company's financial statements. These financial statements have been prepared in accordance with accounting principles generally accepted in Canada and, where appropriate, reflect estimates based on judgment. Management has determined such amounts on a reasonable basis to ensure that the financial statements are presented fairly, in all material respects. Financial information used throughout this Annual Report is consistent with that in the financial statements.

The Company's policy is to maintain systems of internal accounting and administrative control designed to provide reasonable assurance that the financial information is accurate and reliable and that the Company's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors, through the Audit Committee, is responsible for ensuring that management fulfills its financial reporting responsibilities. The Audit Committee meets periodically with management and the auditors to discuss internal accounting, auditing matters, financial reporting issues and to review the financial statements and the auditors' report. The Audit Committee reports its findings to the Board for consideration by the Board when it approves the financial statements for issuance to the shareholders. The Audit Committee recommends the appointment of the Company's auditors who are appointed at the Company's Annual Meeting.

"Art Hesje"

Art Hesje

President & Chief Executive Officer

AUDITORS' REPORT

To the Shareholders of Fytokem Products Inc.

We have audited the balance sheets of Fytokem Products Inc. as at December 31, 2003 and 2002 and the statements of loss and deficit and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"Deloitte & Touche LLP"

Chartered Accountants

Saskatoon, Saskatchewan

March 1, 2004

FYTOKEM PRODUCTS INC.
STATEMENT OF LOSS AND DEFICIT

	Years Ended December 31, 2003	2002
REVENUE		
Sales (Notes 12 and 13)	$ 577,429	$ 546,570
Cost of sales	181,466	168,435
Gross margin	395,963	378,135
Project revenue (Note 14)	49,049	53,062
Marketing agreement revenue (Notes 9 and 15)	360,000	30,000
Other revenue	1,590	2,370
	806,602	463,567
EXPENSES		
Product development	280,229	345,502
Marketing	182,809	202,256
Finance and administration	362,812	391,366
Amortization (Note 6)	42,874	42,131
Interest on debt (Note 7)	81,960	79,956
	950,684	1,061,211
NET LOSS	144,082	597,644
DEFICIT, BEGINNING OF YEAR	4,455,868	3,858,224
DEFICIT, END OF YEAR	$ 4,599,950	$ 4,455,868
BASIC AND DILUTED LOSS PER SHARE (Note 11)	$ 0.01	$ 0.04

See accompanying notes.

FYTOKEM PRODUCTS INC.
BALANCE SHEET

	As at December 31, 2003	2002
CURRENT ASSETS		
Cash and temporary investments	$ 53,278	$ 780,479
Accounts receivable (Note 14)	72,191	37,542
Inventories (Note 4)	208,624	285,917
Prepaid expenses	12,187	27,233
Current portion of deferred marketing costs	63,285	14,023
	409,565	1,145,194
DEFERRED MARKETING COSTS (Note 5)	-	14,023
DEFERRED FINANCE CHARGES	5,039	8,455
CAPITAL ASSETS (Note 6)	125,408	153,817
	$ 540,012	$ 1,321,489
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 145,612	$ 326,015
Current portion of deferred marketing revenue	360,000	360,000
Current portion of long term debt	181,099	189,606
	686,711	875,621
DEFERRED MARKETING REVENUE (Note 9)	-	360,000
LONG TERM DEBT (Notes 7 and 8)	369,097	541,085
	1,055,808	1,776,706
CAPITAL DEFICIENCY		
Common shares (Note 8)	3,775,949	3,692,446
Preferred shares (Note 8)	244,221	244,221
Equity portion of convertible debt (Note 7)	63,984	63,984
Deficit	(4,599,950)	(4,455,868)
	(515,796)	(455,217)
	$ 540,012	$ 1,321,489

See accompanying notes.

APPROVED BY THE BOARD

"Peter Oliver"

Peter Oliver, Director

"Jim Yuel"

Jim Yuel, Director

FYTOKEM PRODUCTS INC.
STATEMENT OF CASH FLOWS

	Years Ended December 31, 2003	2002
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES		
Net loss	$ (144,082)	$ (597,644)
Items not affecting cash		
Amortization	42,874	42,131
Amortization of deferred marketing costs	42,248	1,169
Non-cash interest expense	25,643	16,701
Loss (gain) on sale of fixed assets	168	(380)
	(33,149)	(538,023)
Changes in non-cash working capital		
Accounts receivable	(34,649)	78,263
Inventories	77,293	79,499
Prepaid expenses	15,046	2,491
Deferred marketing costs (Note 5)	(77,487)	(29,215)
Accounts payable and accrued liabilities	(180,403)	23,092
Deferred marketing revenue (Note 9)	(360,000)	720,000
	(593,349)	336,107
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES		
Acquisition of equipment	(4,645)	(7,759)
Proceeds from disposal of equipment	350	380
	(4,295)	(7,379)
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES		
Costs of share issuance	$ (6,597)	$ -
Proceeds from long-term debt (Notes 7 and 8)	-	340,100
Costs of financing long-term debt	-	(2,786)
Repayment of long-term debt	(122,960)	(56,450)
	(129,557)	280,864
NET (DECREASE) INCREASE IN CASH DURING THE YEAR	(727,201)	609,592
CASH POSITION, BEGINNING OF YEAR	780,479	170,887
CASH POSITION, END OF YEAR	$ 53,278	$ 780,479
REPRESENTED BY:		
Cash	$ 53,237	$ 79,988
Short-term investments	41	700,491
	$ 53,278	$ 780,479
SUPPLEMENTAL INFORMATION		
Cash interest paid	$ 52,935	$ 63,255

See accompanying notes.

1. **DESCRIPTION OF BUSINESS**

Fytokem Products Inc. (the Company) was incorporated under *The Business Corporations Act* of Saskatchewan on March 25, 1994. Fytokem Products Inc. is engaged in the discovery and commercialization of novel *Function-Certified™* plant-based substances – extracts, phytochemicals and bioactive molecules – for use as ingredients in personal care, nutraceutical, pharmaceutical and bio-industrial products.

2. **BASIS FOR PRESENTATION**

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future.

The Company has incurred significant losses in the years ended December 31, 2003 and 2002. The Company's ability to continue on as a going concern is dependent upon achieving profitable operations and upon obtaining additional financing. The outcome of these matters cannot be determined at this time.

These financial statements do not contain any adjustments to the amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue its business.

3. **ACCOUNTING POLICIES**

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

(a) Use of Estimates

The preparation of these financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

(b) Translation of Foreign Currencies

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian Dollars at the year end rates of exchange. Revenues and expenses are translated at exchange rates prevailing on the dates on which such items are recognized in earnings. Gains and losses arising from the translation of foreign currency monetary assets and liabilities at each period end are included in earnings.

Prior to November 29, 2002, substantially all product sales were denominated in foreign currency. Therefore, after this date the Company's exposure to the risk of foreign currency fluctuations declined. No foreign exchange hedges were placed to mitigate this risk.

(c) Inventories

Inventory consists of raw materials and finished goods. Inventories are recorded at the lower of cost and estimated net realizable value. Cost is determined on an average cost basis and includes direct materials and processing costs. There are no allocations of internal labour and overhead costs included in the above cost values.

(d) Capital Assets

Equipment is recorded at cost. The cost of additions, and where useful lives are significantly extended, betterments and renewals are capitalized. Repairs and consumable supplies are expensed as incurred.

Amortization is computed using the straight-line method at rates estimated to amortize the cost of the assets over their useful lives.

The Company periodically assesses the amortization period and recoverability of the carrying amount of its equipment to determine potential impairment.

(e) Fair Value

The fair value of financial instruments are generally determined as follows:
Financial instruments included in current assets and current liabilities are all short term in nature and as such, their carrying value approximates fair value.

The fair value of the long term debt with fixed rates of interest are estimated using discounted cash flows based on current rates of interest for similar lending arrangements.

Unless otherwise disclosed in the notes to financial statements, the fair value of an instrument approximates its carrying value.

(f) Deferred Finance Charges

Deferred finance charges relate to the issuance of the convertible debt and are being amortized over a five-year period, with the exception of interest, which is amortized over one year.

(g) Deferred Marketing Costs

In accordance with SEC's Staff Accounting Bulletin (SAB) 101, which is not materially different from Canadian Generally Accepted Accounting Principles (GAAP), the incremental, direct costs of establishing and setup of the Cooperation and License Agreement (Marketing Agreement) (Note 15) are deferred and amortized over the same period as the corresponding revenue is realized.

(h) Revenue Recognition

Revenue includes product sales, project revenue and marketing agreement revenue. Revenue on sales of product is recognized when the goods are shipped to the customer. Project revenue is recognized over time as the projects are completed.

Revenue related to the marketing agreement (Note 15) has been deferred and recognized on a straight-line basis over the period December 1, 2002 through December 31, 2004. This is in accordance with SAB 101, which is not materially different from Canadian GAAP, which requires that an up-front fee, which does not represent the culmination of a separate earnings process, would be amortized over the contract term or expected term of the customer relationship. The Company has determined this period to be the period with firm purchase commitments and firm pricing.

(i) Government Assistance

The Company makes periodic applications for financial assistance under available government incentive programs for project funding and Scientific Research and Experimental Development (SR&ED) tax credits. Government funding for research and development projects is recorded as revenue in the period the related expenditures are incurred, and SR&ED tax credits relating to non-capital expenditures are recorded as a reduction of expenses when the related expenditures are incurred.

(j) Research and Development

Research costs, including research performed under contract by third parties, are expensed as incurred. Development costs, including direct legal and other costs related to patents, are also generally expensed as incurred unless such costs meet the criteria under generally accepted accounting principles for deferral and amortization. To qualify for deferral, the costs must relate to a technically feasible, identifiable product, which the Company intends to produce, and market, there must be a clearly defined market for the product and the Company must have the resources, or access to resources, necessary to complete the development. To date, no development costs have been deferred.

(k) Stock-Based Compensation

Effective January 1, 2002, the Company adopted the CICA Handbook (HB) Section 3870 "Stock-based Compensation and Other Stock-based Payments", which established standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. HB 3870 sets out a fair value based method of accounting that is required for certain, but not all, stock-based transactions.

The new standard permits the Company to continue its existing policy that no compensation cost is recorded on the grant of stock options to employees. Consideration paid by employees on the exercise of stock options is recorded as share capital.

HB 3870, however, does require additional disclosures for options granted to employees, including disclosure of pro-forma earnings and pro-forma earnings per share as if the fair value based accounting method had been used for employee stock options (See Note 8).

(l) Future Income Taxes

The Company follows the asset/liability method of accounting for income taxes. Under this method, future income taxes are determined based on the difference between the carrying value of assets and liabilities and their tax basis using the tax rates expected to be in effect when the asset or liability is settled.

4. INVENTORIES

	2003	2002
Raw materials	$ 158,582	$ 185,702
Finished goods	50,042	100,215
	$ 208,624	$ 285,917

5. DEFERRED MARKETING COSTS

	2003	2002
Opening balance	$ 28,046	$ -
Add: Additions	77,487	29,215
Less: Amortization	(42,248)	(1,169)
	63,285	28,046
Less current portion	(63,285)	(14,023)
Ending balance	$ -	$ 14,023

6. CAPITAL ASSETS

		2003		2002	
	Estimated Life	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Furniture and fixtures	8 years	$ 50,268	$ 34,112	$ 49,341	$ 28,090
Computers and office automation	4 years	94,144	70,481	81,319	57,993
Lab equipment	8 years	189,216	103,627	189,216	79,976
		$ 333,628	$ 208,220	$ 319,876	$ 166,059
Less accumulated amortization		(208,220)		(166,059)	
		$ 125,408		$ 153,817	

Included in the above cost figures are assets under capital leases as follows:

	2003	2002
Computers and office automation	$ 10,337	$ -
Lab equipment	-	75,057
	$ 10,337	$ 75,057

Assets purchased under capital lease and the related capital lease obligation (Note 7(f)) are non-cash transactions.

7. LONG TERM DEBT

	2003	2002
Convertible promissory note	$ 296,123	$ 406,148
Equity portion of promissory note	(19,580)	(37,688)
Debenture #1	263,526	259,407
Debenture #2	-	60,100
Debenture #3	-	30,000
Capital lease obligations	10,127	12,724
	$ 550,196	$ 730,691
Less current portions	(181,099)	(189,606)
	$ 369,097	$ 541,085

(a) Convertible Promissory Note

On February 5, 1999 the Company issued a $500,000 convertible promissory note with monthly principal payments of $10,417 beginning April 1, 2001, and a maturity date of October 1, 2005 to Saskatchewan Opportunities Corporation ("SOCO"). The promissory note is collateralized by a general security agreement.

Effective October 8, 2002, SOCO agreed to assign and transfer its rights and obligations under the loan agreement with Fytokem to CIC Industrial Interests Inc. (CICIII), an affiliated crown corporation. None of the terms or conditions were affected by this assignment.

CICIII has the option at any time during the term of the loan to convert any portion of the outstanding balance of the loan to Common Shares of the Company. The Company can repay the promissory note any time until maturity.

(b) Classification of Liability and Equity Components of Convertible Debt

The Company has assigned carrying amounts to the liability and equity elements of the above financial instrument in accordance with the substance of the contractual arrangement. The Company has determined the carrying amount of

the financial liability by discounting the stream of future cash payments of interest and principal at an estimated market rate of 20% for a similar liability that does not have an associated equity component. The carrying amount of the equity component of the convertible promissory note is $63,984.

(c) Debenture #1

On May 15, 2002, the Company received $250,000 from the Agri-Food Equity Fund in the form of a debenture due July 1, 2007. Interest is payable on a formula of 6% fixed rate plus 6% of net income before income taxes. Interest up to and including June 30, 2003 will be added to the principal balance at that date. Annual payments of principal and interest were to begin on July 1, 2003. In 2003, the Agri-Food Equity Fund agreed to postpone the July 1, 2003 principal payment to July 1, 2007. This debenture is collateralized by a general security agreement.

Prepayment of the debenture is permitted, subject to an earned interest rate to the Agri-Food Equity Fund of 15%.

(d) Debenture #2

On November 27, 2002, the Company received $60,100 from the Agri-Food Equity Fund in the form of a debenture due September 1, 2007. Interest is payable on a formula of 6% fixed rate plus 0.902% of net income before income taxes. The Company is also committed to paying, on the maturity date of September 1, 2007, additional interest equal to the percentage increase in the Common Share price from November 27, 2002 to September 1, 2007. Total interest including the additional interest cannot exceed 60% per year. No security was pledged on this debenture.

On May 1, 2003, the Company converted this debenture into 601,000 Common Shares at a price of $0.10 per Common Share (See Note 8).

(e) Debenture #3

On December 23, 2002, the Company received $30,000 from the Agri-Food Equity Fund in the form of a debenture due September 1, 2007. Interest is payable on a formula of 6% fixed rate plus 0.45% of net income before income taxes. The Company is also committed to paying, on the maturity date of September 1, 2007, additional interest equal to the percentage increase in the Common Share price from December 23, 2002 to September 1, 2007. Total interest including the additional interest cannot exceed 60% per year. No security was pledged on this debenture.

On May 1, 2003, the Company converted this debenture into 300,000 Common Shares at a price of $0.10 per Common Share (See Note 8).

The principal payments on long-term debt due within the next four years are:

2004	$181,099
2005	227,621
2006	57,674
2007	103,382

(f) Lease Obligations

The capital lease obligation is at a fixed rate of 13.78%. The operating lease obligations are primarily for the Company's rented office and lab space at its head office in Saskatoon. Minimum lease payments are as follows:

	Capital leases	Operating leases
2004	$ 3,946	$ 63,752
2005	3,946	48,785
2006	4,651	-
	$ 12,543	$ 112,537
Less interest portion	(2,416)	-
	$ 10,127	$ 112,537

8. SHARE CAPITAL

a) Authorized

Unlimited number of Common Shares without nominal or par value and an unlimited number of Preferred shares.

b) Common Shares

Date		Common Shares Issued	Net Proceeds
December 31, 2002	Balance	14,462,121	$ 3,692,446
May 01, 2003	Conversion of $60,100 in Debentures	601,000	60,100
May 01, 2003	Conversion of $30,000 in Debentures	300,000	30,000
May 01, 2003	Issue Costs	-	(6,597)
December 31, 2003	Balance	15,363,121	$ 3,775,949

On May 1, 2003, the Company issued 601,000 Common Shares at a price of $0.10 per Common Share upon full conversion of $60,100 of Debenture #2 (See Note 7(d)).

On May 1, 2003, the Company issued 300,000 Common Shares at a price of $0.10 per Common Share upon full conversion of $30,000 of Debenture #3 (See Note 7(e)).

c) Preferred Shares

The Company amended its Articles of Incorporation on October 15, 2001 to create the "Series A Preferred Shares" class of Preferred Shares. This class of preferred shares is limited to 400,000.

The holders of the Series A Preferred Shares will be entitled to a fixed annual 6% dividend and will also be entitled to a participating dividend of 6% of net income, subject to certain restrictions. These shares are redeemable at the option of the Company over a three-year period, with one-third of the shares redeemable each year, commencing in January 2005, and are convertible to Common Shares by the holder subsequent to the redemption date for such shares, subject to certain conditions. The fixed annual dividend rate becomes 10% in the event the Company does not redeem shares when available and these shares are not converted to Common Shares by the holder.

On October 18, 2001, the Company issued 250,000 Series A Preferred Shares for cash proceeds of $250,000 to the Saskatchewan Agri-Food Equity Fund. Issue costs of $5,779 have been netted against the proceeds of their shares.

Cumulative dividends on these shares to December 31, 2003 are $33,041 (2002: $18,041). These dividends have not been declared or paid. Unpaid fixed annual dividends are subject to a 15% interest rate.

d) Stock-Based Compensation

Stock Option Plan

A Stock Option Plan was authorized by the Board of Directors of the Company and approved by the shareholders of the Company on June 30, 2000 to provide incentive to qualified parties to increase their proprietary interest in the Company and thereby encourage their continuing association with the Company.

The maximum number of shares, which can be issued under the Stock Option Plan, is 2,400,000 Common Shares. Notwithstanding the above, the maximum number of shares reserved for issuance to any one person upon the exercise of Options is limited to 5 percent of the total number of shares then outstanding.

	2003		2002	
	Shares (000)	Weighted-Average Exercise Price	Shares (000)	Weighted-Average Exercise Price
Outstanding at beginning of year	1,300	$0.23	1,105	$0.30
Granted	-	-	375	0.10
Expired	(35)	0.26	-	-
Forfeited	(515)	0.27	(180)	0.36
Outstanding at end of year	750	$0.20	1,300	$0.23
Options exercisable at year end	563	$0.24	745	$0.26

	Options outstanding		Options exercisable
Range of exercise prices	Number of options (000)	Weighted-average remaining contractual life	Number of options (000)
$ 0.10	210	3.88	23
0.13	185	2.57	185
0.25	170	2.12	170
0.27	75	.44	75
0.34	84	1.24	84
0.60	26	1.55	26
Total	750	2.00	563

Options are exercisable by the holder based on combination of both the performance conditions being met and the vesting conditions being met. The Options under this Stock Option Plan vest after the following time has passed from the grant date: 50% after six months; 25% after twelve months and 25 % after eighteen months.

On October 9, 2002, the Company granted share options to an employee to purchase 85,000 shares at a price of $0.10 per Common Share. All of these options were forfeited in the year.

On November 18, 2002, the Company granted share options to the directors, officers and employees to purchase an aggregate of 290,000 shares at a price of $0.10 per Common Share. 210,000 of these remain outstanding at year end and expire on November 18, 2007. 22,500 of these options are vested and exercisable as of year end.

Fair Value of Stock-Based Compensation

Pro forma information regarding net loss is required by the new CICA Handbook section 3870 (HB 3870), and has been determined as if the Company had accounted for its employee stock options issued subsequent to December 31, 2001 under the fair value method. Had the Company determined compensation expense costs based on the fair value at the date of grant for stock options under HB 3870, the Company's loss would have decreased by $1,908 (2002: ($4,608)) to $142,174 (2002: $602,252). There would be no change in the loss per share.

The fair value of each option grant is estimated as of the date of grant using the Black Scholes options pricing model. The following weighted average assumptions were used for grants in the year: expected dividend yield of 0%; expected volatility of 127.17%; risk-free interest rate of 4.25%, and expected life of 5 years.

The weighted average fair value of the options granted in 2002 amounted to $0.09. The Company has included this value per option in the calculation of its proforma net loss per share.

9. DEFERRED MARKETING REVENUE

	2003	2002
Opening balance	$ 720,000	$ -
Funds received (Note 15)	-	750,000
Revenues recognized	(360,000)	(30,000)
	360,000	720,000
Less current portion	(360,000)	(360,000)
Ending balance	$ -	$ 360,000

10. INCOME TAXES

The Company has losses totaling $4,231,918 at December 31, 2003 (2002: $3,671,245) available to reduce future taxable income. The expiration dates for these losses are as follows:

2004	$ 413,375
2005	702,826
2006	931,497
2007	935,286
2008	688,261
2009	560,673

Temporary differences, including the above losses, which would have given rise to a future tax asset balance, amount to $4,791,153 at December 31, 2003 (2002: $4,640,902). Other than the losses discussed above, these temporary differences can be carried forward indefinitely. The potential tax benefit of these items has not been reflected in these financial statements.

SR&ED tax credits of $NIL in 2003 (2002: $147,186) are available to carry forward to the future years for offset against income taxes otherwise payable. The potential tax benefit of this has not been reflected in these financial statements.

The expiration date of these tax credits are as follows:

2005	$ 16,877
2006	16,243
2007	5,049
2008	30,510
2009	38,188
2010	5,722
2011	12,180
2012	22,417

11. LOSS PER SHARE

Basic loss per share is calculated on the weighted average number of shares issued and outstanding during the year ended.

Due to the fact that all potentially dilutive instruments issued and outstanding during each period are anti-dilutive, the diluted loss per share is equal to the basic loss per share for all periods. The weighted average number of shares issued in each of the periods are as follows:

Year ended December 31, 2003	15,066,902
Year ended December 31, 2002	14,462,121

12. ECONOMIC DEPENDENCE

During the year, the Company had sales to one distributor that represented 97% of product sales (2002: 79%) (Note 13). The revenue from this distributor represented 93% of total revenue for the year (2002: 69%).

13. SEGMENTED INFORMATION

The Company's operations include one reportable segment. All of the Company's operations, employees and assets are located in Canada. In 2003, the majority of the Company's product sales are made to a customer in Canada (Note 12). In 2002, the majority of the Company's product sales were made to customers in the United States.

14. GOVERNMENT ASSISTANCE

During the year, the Company recorded as project revenue, government assistance of $48,919 (2002: $51,801). Of this amount, $11,536 (2002: $7,702) was receivable at year end.

15. CONTRACTUAL OBLIGATIONS

The Company entered into a Cooperation and License Agreement with Atrium Biotechnologies Inc. (Atrium) of Quebec City, PQ on October 24, 2002, pursuant to which the Company granted to Atrium the sole and exclusive right to distribute and sell all of the Company's existing products, as well as other products that may be agreed upon from time to time, to the personal care industry. The Company received $750,000 (Note 9) from Atrium for this right.

The agreement is perpetual in nature, subject to Atrium's performance. Atrium committed to firm minimum purchase commitments for the first two years of the agreement and Fytokem agreed to firm pricing for this same period. Atrium also agreed to purchase the Dragoco inventory that Fytokem agreed to repurchase. This resale of inventory to Atrium was not included in Fytokem's product sales for the year. A $61,038 loss on disposal of these goods was added to the deferred marketing costs in the year. In addition, during the contract year of 2004, the Company agreed to replace, at no cost to Atrium, the product purchased by Atrium during 2003 that Atrium is unable to sell to its clients because the remaining shelf life of such product is too short. No liability has been accrued in the financial statements, as the occurrence of this future event is not determinable.

The Dragoco Strategic Co-operation Agreement entered into in July, 2000 was terminated, effective November 29, 2002. Fytokem repurchased from Dragoco all product inventories in saleable condition. This amounted to US $138,207 ($209,024 CDN). Dragoco provided Fytokem with market information it required for the transition to Atrium. Fytokem also purchased certain research studies from Dragoco at a cost of US $32,200 ($50,876 CDN) in the year.

Under the terms of the Dragoco agreement, the Company, in addition to the purchase price paid for product, was granted a royalty payment of 5% of the gross sales of all products sold by Dragoco in Canada, the United States and Japan during the first three years of the agreement. The Company has recorded $NIL (2002: $11,796) of royalties in its sales for the year.

16. COMPARATIVE FIGURES

Certain of the prior period's figures have been reclassified to conform to the current year's presentation.

SHAREHOLDER INFORMATION

FYTOKEM PRODUCTS INC.

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BOARD OF DIRECTORS

Jim Yuel (Chairman), Brad Laidlaw, Peter Oliver, Dale Botting

OFFICERS

Art Hesje, President and CEO

SHAREHOLDER CONTACT

Art Hesje, President and CEO
(306) 668-2552
ahesje@fytokem.com

STOCK INFORMATION

TSX Venture Exchange

Stock Symbol:	FYT
Shares Outstanding	15,363,121
2003 Share Price Range:	\$0.08 to \$0.20

AUDITORS

Deloitte & Touche LLP
Chartered Accounts
Saskatoon SK

TRANSFER AGENT AND REGISTRAR

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THE ANNUAL AND SPECTIAL MEETING OF SHAREHOLDERS WILL BE HELD ON

Friday, June 25, 2004 at 2:00 p.m.
Golden Room, 2nd Floor, Atrium Building
Innovation Place
111 Research Drive
Saskatoon SK

Corporate Profile

Fytokem Products Inc. is engaged in the discovery and commercialization of novel *Function-Certified*™ plant-based substances – extracts, phytochemicals and bioactive molecules – for use as active ingredients in personal care, nutraceutical, pharmaceutical and bio-industrial products.

The Company's vision is to become a dominant supplier of unique high-value *Function-Certified*™ plant-based substances – extracts, phytochemicals and bioactive molecules based on plants of the Northern Canadian Prairie.

The Company's mission is to maximize our sustainable growth and profitability through developing and delivering consistent quality plant-based ingredients to selected strategic partners and customers on a consistent basis. We will develop and deliver products to our partners based on defined market opportunities.

Key Elements of The Company's Business Strategy Include:

- Development of products targeted to market-defined opportunities. Strategic partners will provide product development guidance and direction, and in some cases, help fund these development programs.
- Utilization of strategic partners to market the Company's products in specific markets on a global basis to maximize market exposure while minimizing direct marketing costs.
- The Company will continue to focus its efforts on the development and supply of unique high-margin, non-commodity products.
- The Company's growing sales revenues are expected to fund its finance, administration, basic quality control and marketing functions. Additional funds will need to raised as necessary to support specific product and market development projects.

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